

## **The Treasury Management Policy Statement 2018/19**

South Holland District Council defines its treasury management activities as:

1. The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.
2. This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.
3. This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

## Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Strategy 2018/19

### 1 Introduction

#### 1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as "the management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

The Council's treasury function is undertaken by Compass Point Business Services (East Coast) Ltd (CPBS) on behalf of the Council.

#### 1.2 Reporting requirements

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

**Prudential and treasury indicators and treasury strategy (this report)** - The first, and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

**A mid-year treasury management report** – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

**An annual treasury report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

**Scrutiny** - The above reports are required to be adequately scrutinised before being recommended to the Council and this role is undertaken by the Governance and Audit Committee.

### 1.3 Treasury Management Strategy for 2018/19

The strategy for 2018/19 covers two main areas:

#### Capital issues

- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) policy.

#### Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- the policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, Department for Communities and Local Government (DCLG) Minimum Revenue Provision (MRP) Guidance, the CIPFA Treasury Management Code and DCLG Investment Guidance.

### 1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. The Council is currently in the process of arranging treasury management training for members to take place in the first quarter of 2018.

The training needs of CPBS treasury management officers are reviewed on an ongoing basis.

### 1.5 Training management consultants

CPBS uses Link Asset Services (previously known as Capita Asset Services) as external treasury management advisors for the Council.

The Council recognises that responsibility for treasury management decisions remains with the Council at all times and will ensure that undue reliance is not placed upon external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

## 2 The Capital Prudential Indicators 2018/19 to 2021/22

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist Members' overview and confirm capital expenditure plans.

### 2.1 Capital Expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members approve capital expenditure forecasts as part of the annual Budget report.

The capital expenditure plans mirror those within the budget report and will be amended throughout the year as spending plans alter.

The table below summarises the capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Table 1

Capital Expenditure £'000's	2016/17 Actual	2017/18 Latest Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
General Fund	1,924	5,065	4,065	5,497	3,483	2,133
Housing Revenue Account	3,052	10,007	9,220	9,193	8,394	7,594
<b>Total Expenditure</b>	<b>4,976</b>	<b>15,072</b>	<b>13,285</b>	<b>14,690</b>	<b>11,877</b>	<b>9,727</b>
<b>Financed by:</b>						
Capital Receipts	10	2,298	1,821	910	3,300	1,127
Capital Grants & Contributions	607	1,232	1,556	746	1,499	660
Major Repairs Reserve	3,036	4,868	8,100	4,366	3,041	3,102
Direct Revenue Financing	36	5,668	100	5,608	2,579	3,365
<b>Total Funding</b>	<b>3,689</b>	<b>14,066</b>	<b>11,577</b>	<b>11,630</b>	<b>10,419</b>	<b>8,254</b>
<b>Net financing need for the year</b>	<b>1,287</b>	<b>1,006</b>	<b>1,708</b>	<b>3,060</b>	<b>1,458</b>	<b>1,473</b>

The financing need reflects actual and planned expenditure to Welland Homes Limited from 2016/17 through to 2021/22.

### 2.2 The Council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

The CFR includes any other long term liabilities (e.g. Public Finance Initiative (PFI) schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the

Council is not required to separately borrow for these schemes. The Council currently has no such schemes within the CFR.

As part of the formal governance process, the Council approves the CFR projections as follows:

Table 2

£000's	2016/17 Actual	2017/18 Latest Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
<b>Capital Financing Requirement</b>						
CFR – Non HRA	2,556	3,562	5,270	8,330	9,788	11,261
CFR - HRA	68,610	68,610	68,610	68,610	68,610	68,610
<b>Total CFR</b>	<b>71,166</b>	<b>72,172</b>	<b>73,880</b>	<b>76,940</b>	<b>78,398</b>	<b>79,871</b>
<b>Movement in CFR</b>	<b>1,274</b>	<b>1,006</b>	<b>1,708</b>	<b>3,060</b>	<b>1,458</b>	<b>1,473</b>
<b>Movement in CFR represented by:</b>						
Net financing need for the year (above)	1,287	1,006	1,708	3,060	1,458	1,473
Less MRP/VRP and other financing movements	(13)	0	0	0	0	0
<b>Movement in CFR</b>	<b>1,274</b>	<b>1,006</b>	<b>1,708</b>	<b>3,060</b>	<b>1,458</b>	<b>1,473</b>

Of the total CFR, £67.456m relates to the borrowing taken out with the Public Works Loan Board (PWLB) as part of the Housing Self Financing changes. The projected increases in the CFR through to 2021/22 are the additional loans and equity stakes in Welland Homes which are classed as capital expenditure and financed from internal cash balances.

### 2.3 Minimum revenue provision (MRP) policy statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

DCLG Regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Existing practice** - MRP will follow the existing practice outlined in former DCLG regulations (option 1)

These options provide for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

- **Asset Life Method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3)

These options provide for a reduction in the borrowing need over approximately the asset's life.

There is no requirement on the Housing Revenue Account (HRA) to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place).

Repayments included in finance leases are applied as MRP.

Any loans issued or equity investment made in Welland Homes and South Holland Local Housing Company which are classed as capital expenditure will increase the Council's CFR. The Council will earmark the proceeds from the repayment of the loans or sale of equity interest to reduce the CFR and therefore will not apply MRP on such loans or equity investments. This policy will be reviewed annually.

Appropriation of Assets – Where assets do not change ownership and borrowing is not required; the Council will not apply MRP on the asset value transferred.

## **2.4 Core funds and expected investment balances**

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Table 3

<b>Year End Resources £'000's</b>	<b>2016/17 Actual</b>	<b>2017/18 Latest Estimate</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>	<b>2020/21 Estimate</b>	<b>2021/22 Estimate</b>
General Fund Balance	2,064	2,064	2,064	2,064	2,064	2,064
HRA Working Balance	8,968	12,507	15,646	14,914	17,051	17,356
HRA Insurance Reserve	200	200	200	200	200	200
Major Repairs Reserve	6,697	6,561	1,384	0	0	0
Earmarked Reserves	8,342	7,379	7,426	6,701	6,134	6,771
Capital Grants Unapplied	1,969	2,154	2,079	2,004	2,004	2,004
Capital Receipts	3,571	3,518	2,588	2,602	2,287	2,151
<b>Total core funds</b>	<b>31,811</b>	<b>34,383</b>	<b>31,387</b>	<b>28,485</b>	<b>29,740</b>	<b>30,546</b>
Working Capital*	5,592	5,592	5,592	5,592	5,592	5,592
Under Borrowing	(3,710)	(4,716)	(6,424)	(9,484)	(10,942)	(12,415)
<b>Expected investments</b>	<b>33,693</b>	<b>35,259</b>	<b>30,555</b>	<b>24,593</b>	<b>24,390</b>	<b>23,723</b>

Working capital balances shown are estimated year end; these may be higher mid-year.

## 2.5 Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework, prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. As part of the formal governance process, the Council approves the following indicators:

### *Ratio of financing costs to net revenue stream*

This indicator identifies the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream. Where financing costs to net revenue stream are negative, this is because the Council is earning interest on its balances as opposed to paying interest on its borrowing.

Table 4

%	2016/17 Actual	2017/18 Latest Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Non-HRA	(1.28%)	(1.34%)	(1.85%)	(2.93%)	(4.12%)	(4.39%)
HRA	29.60%	34.59%	35.40%	35.25%	35.11%	34.26%

### *Incremental impact of capital investment decisions on council tax levels*

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

Table 5

£	2016/17 Actual	2017/18 Latest Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Council tax - band D	0.04	0.22	0.21	0.14	0.00	0.00

### *Incremental impact of capital investment decisions on housing rent levels*

Similar to the council tax calculation, this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

Table 6

£	2016/17 Actual	2017/18 Latest Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Weekly Housing Rent Levels	0.09	0.18	0.39	0.34	0.61	0.48

## HRA Ratios

Table 7

	2016/17 Actual	2017/18 Latest Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
HRA debt £'000's	67,456	67,456	67,456	67,456	67,456	67,456
HRA revenues £'000,s	15,307	14,897	14,713	14,942	15,171	15,727
<b>Ratio of debt to revenues (%)</b>	<b>441</b>	<b>453</b>	<b>458</b>	<b>451</b>	<b>445</b>	<b>429</b>

Table 8

	2016/17 Actual	2017/18 Latest Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
HRA debt £'000's	67,456	67,456	67,456	67,456	67,456	67,456
Number of HRA dwellings	3,829	3,800	3,800	3,800	3,804	3,818
<b>Debt per dwelling (£)</b>	<b>17,617</b>	<b>17,751</b>	<b>17,751</b>	<b>17,751</b>	<b>17,733</b>	<b>17,668</b>

### 3 Borrowing

The capital expenditure plans set out in the Prudential Indicators (above) provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

#### 3.1 Current portfolio position

The Council's treasury portfolio position at 31 March 2017, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations) against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Table 9

£'000's	2016/17 Actual	2017/18 Latest Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Debt at 1 April	67,456	67,456	67,456	67,456	67,456	67,456
Expected change in Debt	0	0	0	0	0	0
Other long-term liabilities (OLTL)	0	0	0	0	0	0
Expected change in OLTL	0	0	0	0	0	0
<b>Actual gross debt at 31 March</b>	<b>67,456</b>	<b>67,456</b>	<b>67,456</b>	<b>67,456</b>	<b>67,456</b>	<b>67,456</b>
<b>The Capital Financing Requirement</b>	<b>71,166</b>	<b>72,172</b>	<b>73,880</b>	<b>76,940</b>	<b>78,398</b>	<b>79,871</b>
<b>Under / (over) borrowing</b>	<b>3,710</b>	<b>4,716</b>	<b>6,424</b>	<b>9,484</b>	<b>10,942</b>	<b>12,415</b>

Within the prudential indicators, there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

The Section 151 Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

### 3.2 Treasury Indicators: limits to borrowing activity

**The operational boundary** - This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Table 10

Operational boundary £'000's	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Debt	79,360	86,000	86,000	86,000	86,000
Other long term liabilities	1,000	1,000	1,000	1,000	1,000
Total	80,360	87,000	87,000	87,000	87,000

**The authorised limit for external debt** - A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt, which while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has never been exercised.
2. As part of the formal governance process, the Council approves the following indicators, as shown below:

Table 11

Authorised limit £'000's	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Debt	89,456	90,000	90,000	90,000	90,000
Other long term liabilities	1,000	1,000	1,000	1,000	1,000
Total	90,456	91,000	91,000	91,000	91,000

Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

Table 12

HRA Debt Limit £'000	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Total	74,701	74,701	74,701	74,701	74,701

### 3.3 Prospect for interest rates (as at 27/11/17)

Link Asset Services has been appointed as the Council's treasury advisor and part of their service is to assist the Council to formulate a view on interest rates.

A more detailed interest rate forecast and economic commentary are shown at **Appendix G2a**.

The following table gives the Link Asset Services' central view:

Table 13

	Bank Rate %	PWLB Borrowing Rates% (including certainty rate adjustment)			
		5 year	10 year	25 year	50 year
Mar 2018	0.50	1.60	2.20	2.90	2.60
Jun 2018	0.50	1.60	2.30	3.00	2.70
Sep 2018	0.50	1.70	2.40	3.00	2.80
Dec 2018	0.75	1.80	2.40	3.10	2.90
Mar 2019	0.75	1.80	2.50	3.10	2.90
Jun 2019	0.75	1.90	2.60	3.20	3.00
Sep 2019	0.75	1.90	2.60	3.20	3.00
Dec 2019	1.00	2.00	2.70	3.30	3.10
Mar 2020	1.00	2.10	2.70	3.40	3.20
Jun 2020	1.00	2.10	2.80	3.50	3.30
Sep 2020	1.25	2.20	2.90	3.50	3.30
Dec 2020	1.25	2.30	2.90	3.60	3.40
Mar 2021	1.25	2.30	3.00	3.60	3.40

#### Commentary from Link Asset Services

As expected, the Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November. This removed the emergency cut in August 2016 after the European Union (EU) referendum. The MPC also gave forward guidance that they expected to increase Bank rate only twice more by 0.25% by 2020 to end at 1.00%. The Link Asset Services forecast as above includes increases in Bank Rate of 0.25% in November 2018, November 2019 and August 2020.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected, that at some point, there would be a more protracted move from bonds to equities after a historic long-term trend, over about the last 25 years, of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial Quantitative Easing, added further impetus to this downward trend in bond yields and rising bond prices. Quantitative Easing has also directly led to a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election in November 2016 has called into question whether the previous trend may go into reverse, especially now the Fed. has taken the lead in reversing monetary policy by starting, in October 2017, a policy of not fully reinvesting proceeds from bonds that it holds when they mature.

Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as stronger economic growth becomes more firmly established. The Fed. has started raising interest rates and this trend is expected to continue during 2018 and 2019. These increases will

make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US are likely to exert some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure is likely to be dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

From time to time, gilt yields – and therefore PWLB rates - can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis and emerging market developments. Such volatility could occur at any time during the forecast period.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts (and MPC decisions) will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

The overall balance of risks to economic recovery in the UK is probably to the downside, particularly with the current level of uncertainty over the final terms of Brexit.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Bank of England monetary policy takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
- Weak capitalisation of some European banks.
- The result of the October 2017 Austrian general election is likely to result in a strongly anti-immigrant coalition government. In addition, the new Czech prime minister is expected to be Andrej Babis who is strongly against EU migrant quotas and refugee policies. Both developments could provide major impetus to other, particularly former Communist bloc countries, to coalesce to create a major block to progress on EU integration and centralisation of EU policy. This, in turn, could spill over into impacting the Euro, EU financial policy and financial markets.
- Rising protectionism under President Trump
- A sharp Chinese downturn and its impact on emerging market countries

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.
- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of Quantitative Easing, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.

**Investment and borrowing rates**

- Investment returns are likely to remain low during 2018/19 but to be on a gently rising trend over the next few years.
- Borrowing interest rates increased sharply after the result of the general election in June and then also after the September MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. Since then, borrowing rates have eased back again somewhat. Apart from that, there has been little general trend in rates during the current financial year. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;
- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

**(End of Link Asset Services commentary)****3.4 Borrowing Strategy**

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

Against this background and the risks within the economic forecast, caution will be adopted with the 2018/19 treasury operations. The Section 151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.*
- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.*

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

**3.5 Treasury management limits on activity**

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

## APPENDIX G2

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

As part of the formal governance process, the Council approves the treasury indicators, as follows:

Table 14

£,000's	2018/19	2019/20	2020/21	2021/22
<b>Interest rate exposures</b>				
	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>
<b>Limits on fixed interest rates based on net debt</b>	87,000	87,000	87,000	87,000
<b>Limits on variable interest rates based on net debt</b>	8,000	8,000	8,000	8,000
<b>Limits on fixed interest rates:</b>				
• <b>Debt only</b>	87,000	87,000	87,000	87,000
• <b>Investments only</b>	(35,000)	(35,000)	(35,000)	(35,000)
<b>Limits on variable interest rates:</b>				
• <b>Debt only</b>	8,000	8,000	8,000	8,000
• <b>Investments only</b>	(15,000)	(15,000)	(15,000)	(15,000)
<b>Maturity structure of fixed interest rate borrowing 2018/19</b>				
		<b>Lower</b>	<b>Upper</b>	
Under 12 months		0%	100%	
12 months to 2 years		0%	100%	
2 years to 5 years		0%	100%	
5 years to 10 years		0%	100%	
10 years to 20 years		0%	100%	
20 years to 30 years		0%	100%	
30 years to 40 years		0%	100%	
40 years to 50 years		0%	100%	
<b>Maturity structure of variable interest rate borrowing 2018/19</b>				
		<b>Lower</b>	<b>Upper</b>	
Under 12 months		0%	10%	
12 months to 2 years		0%	10%	
2 years to 5 years		0%	10%	
5 years to 10 years		0%	10%	
10 years to 20 years		0%	10%	
20 years to 30 years		0%	10%	
30 years to 40 years		0%	10%	
40 years to 50 years		0%	10%	

### **3.6 Policy on borrowing in advance of need**

The Council will not borrow more than or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

### **3.7 Debt rescheduling**

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to Cabinet at the earliest meeting following its action.

### **3.8 Municipal Bonds Agency**

It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. It is also hoped that the borrowing rates will be lower than those offered by the PWLB. This Authority intends to make use of this new source of borrowing as and when appropriate.

## 4 Annual Investment Strategy 2018/19

### 4.1 Investment policy

The Council's investment policy has regard to the DCLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

In accordance with the above guidance from the DCLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

The Council's funds are managed by CPBS with reference to a detailed cash flow forecast on a daily basis for the current year. Protocols are in place to govern the movement of funds within specific limits.

Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as credit default swaps (CDS) and overlay that information on top of the credit ratings.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

Investment instruments identified for use in the financial year are listed in **Appendix G2b** under the 'specified' and 'non-specified' investments categories.

The maximum total investments to any individual financial institution or its parent group is £5m. The maximum limit for individual money market funds is £10m.

### 4.2 Creditworthiness policy

This Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to

determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years\*
- Dark Pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
- Light Pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

*\* Please note: the yellow colour category is for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt.*

The Link Asset Services' creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored daily. CPBS is alerted to changes to ratings of all three agencies through its use of the Link Asset Services creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings CPBS will be advised of information in movements in CDS spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on any external support for banks to help support its decision making process.

### 4.3 Country limits

The Council has determined that it will only use approved counterparties from the United Kingdom or countries with a minimum sovereign credit rating of AA- from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are shown in **Appendix G2c**. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

#### 4.4 Investment strategy

Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Bank Rate is forecast to stay flat at 0.50% until quarter 4 2018 and not to rise above 1.25% by quarter 1 2021. Bank Rate forecasts for financial year ends (March) are:

- 2017/18           0.50%
- 2018/19           0.75%
- 2019/20           1.00%
- 2020/21           1.25%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

- 2017/18           0.40%
- 2018/19           0.60%
- 2019/20           0.90%
- 2020/21           1.25%
- 2021/22           1.50%
- 2022/23           1.75%
- 2023/24           2.00%
- Later years        2.75%

The overall balance of risks to these forecasts is currently skewed to the upside and are dependent on how strong Gross Domestic Product (GDP) growth turns out, how quickly inflation pressures rise and how quickly the Brexit negotiations move forward positively.

**Investment treasury indicator and limit** - total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

As part of the formal governance process, the Council approves the treasury indicator and limit, as follows:

Table 1

<b>Maximum principal sums invested &gt; 364 days</b>				
<b>£'000's</b>	<b>2018/19</b>	<b>2019/20</b>	<b>2020/21</b>	<b>2021/22</b>
Principal sums invested > 364 days	£m 5,000	£m 5,000	£m 5,000	£m 5,000

Loans to and equity purchases in Welland Homes do not count towards this limit as they are classed as non-treasury investments.

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

### **4.5 Investment risk benchmark**

The Council has not adopted any formal benchmarks in this area, as Officers believe that decisions on counterparties and maximum investment levels are adequate to monitor the current and trend position, and amend the operational strategy to manage risk as conditions change.

The Council aims to achieve an internal return above the average 3 month London Interbank Bid Rate (LIBID).

### **4.6 End of year investment report**

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

## **Economic Background – Commentary provided by Link Asset Services**

**GLOBAL OUTLOOK.** World growth looks to be on an encouraging trend of stronger performance, rising earnings and falling levels of unemployment. In October, the IMF upgraded its forecast for world growth from 3.2% to 3.6% for 2017 and 3.7% for 2018.

In addition, **inflation prospects are generally muted** and it is particularly notable that **wage inflation** has been subdued despite unemployment falling to historically very low levels in the UK and US. This has led to many comments by economists that there appears to have been a fundamental shift downwards in the Phillips curve (this plots the correlation between levels of unemployment and inflation e.g. if the former is low the latter tends to be high). In turn, this raises the question of what has caused this. The likely answers probably lay in a combination of a shift towards flexible working, self-employment, falling union membership and a consequent reduction in union power and influence in the economy, and increasing globalisation and specialisation of individual countries, which has meant that labour in one country is in competition with labour in other countries which may be offering lower wage rates, increased productivity or a combination of the two. In addition, technology is probably also exerting downward pressure on wage rates and this is likely to grow with an accelerating movement towards automation, robots and artificial intelligence, leading to many repetitive tasks being taken over by machines or computers. Indeed, this is now being labelled as being the start of the **fourth industrial revolution**.

### **KEY RISKS - central bank monetary policy measures**

Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as Quantitative Easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

The key issue now is that that period of stimulating economic recovery and warding off the threat of deflation is coming towards its close and a new period has already started in the US, and more recently in the UK, on reversing those measures i.e. by raising central rates and (for the US) reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of an on-going reduction in spare capacity in the economy, and of unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this then also encouraged investors into a search for yield and into investing in riskier assets such as equities. This resulted in bond markets and equity market prices both rising to historically high valuation levels simultaneously. This, therefore, makes both asset categories vulnerable to a sharp correction. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery by taking too rapid and too strong action, or, alternatively, let inflation run away by taking action that was too slow and/or too weak. **The potential for central banks to get this timing and strength of action wrong are now key risks.**

There is also a potential key question over whether economic growth has become too dependent on strong central bank stimulus and whether it will maintain its momentum against a backdrop of rising interest rates and the reversal of QE. In the UK, a key

vulnerability is the **low level of productivity growth**, which may be the main driver for increases in wages; and **decreasing consumer disposable income**, which is important in the context of consumer expenditure primarily underpinning UK GDP growth.

A further question that has come to the fore is whether **an inflation target for central banks of 2%**, is now realistic given the shift down in inflation pressures from internally generated inflation, (i.e. wage inflation feeding through into the national economy), given the above mentioned shift down in the Phillips curve.

- Some economists favour a shift to a **lower inflation target of 1%** to emphasise the need to keep the lid on inflation. Alternatively, it is possible that a central bank could simply 'look through' tepid wage inflation, (i.e. ignore the overall 2% inflation target), in order to take action in raising rates sooner than might otherwise be expected.
- However, other economists would argue for a **shift UP in the inflation target to 3%** in order to ensure that central banks place the emphasis on maintaining economic growth through adopting a slower pace of withdrawal of stimulus.
- In addition, there is a strong argument that central banks should **target financial market stability**. As mentioned previously, bond markets and equity markets could be vulnerable to a sharp correction. There has been much commentary, that since 2008, QE has caused massive distortions, imbalances and bubbles in asset prices, both financial and non-financial. Consequently, there are widespread concerns at the potential for such bubbles to be burst by exuberant central bank action. On the other hand, too slow or weak action would allow these imbalances and distortions to continue or to even inflate them further.
- Consumer debt levels are also at historically high levels due to the prolonged period of low cost of borrowing since the financial crash. In turn, this cheap borrowing has meant that **other non-financial asset prices**, particularly house prices, have been driven up to very high levels, especially compared to income levels. Any sharp downturn in the availability of credit, or increase in the cost of credit, could potentially destabilise the housing market and generate a sharp downturn in house prices. This could then have a destabilising effect on consumer confidence, consumer expenditure and GDP growth. However, no central bank would accept that it ought to have responsibility for specifically targeting house prices.

**UK.** After the UK surprised on the upside with strong economic growth in 2016, **growth in 2017 has been disappointingly weak**; quarter 1 came in at only +0.3% (+1.8% y/y), quarter 2 was +0.3% (+1.5% y/y) and quarter 3 was +0.4% (+1.5% y/y). The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the EU referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 80% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the **manufacturing sector** which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year while robust world growth has also been supportive. However, this sector only accounts for around 10% of GDP so expansion in this sector will have a much more muted effect on the overall GDP growth figure for the UK economy as a whole.

While the Bank of England is expected to give forward guidance to prepare financial markets for gradual changes in policy, the **Monetary Policy Committee, (MPC), meeting of 14 September 2017** managed to shock financial markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise soon. The Bank of England Inflation Reports during 2017 have clearly flagged up that it expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. The Bank revised its forecast for the peak to just over 3% at the 14 September meeting. (Inflation actually came in at 3.0% in both September and October so that might prove now to be the peak.) This marginal revision in the Bank's forecast can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment having already fallen to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that **the amount of spare capacity in the economy was significantly diminishing** towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of automation and globalisation. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a *decrease* in such globalisation pressures in the UK, and so this would cause additional inflationary pressure over the next few years.

At Its 2 November meeting, the MPC duly delivered a 0.25% increase in Bank Rate. It also gave forward guidance that they expected to increase Bank Rate only twice more in the next three years to reach 1.0% by 2020. This is, therefore, not quite the 'one and done' scenario but is, nevertheless, a very relaxed rate of increase prediction in Bank Rate in line with previous statements that Bank Rate would only go up very gradually and to a limited extent.

However, some forecasters are flagging up that they expect growth to accelerate significantly towards the end of 2017 and then into 2018. This view is based primarily on the coming fall in inflation, (as the effect of the effective devaluation of sterling after the EU referendum drops out of the CPI statistics), which will bring to an end the negative impact on consumer spending power. In addition, a strong export performance will compensate for weak services sector growth. If this scenario was indeed to materialise, then the MPC would be likely to accelerate its pace of increases in Bank Rate during 2018 and onwards.

It is also worth noting the **contradiction within the Bank of England** between action in 2016 and in 2017 **by two of its committees**. After the shock result of the EU referendum, the **Monetary Policy Committee (MPC)** voted in August 2016 for emergency action to cut Bank Rate from 0.50% to 0.25%, restarting £70bn of QE purchases, and also providing UK banks with £100bn of cheap financing. The aim of this was to lower borrowing costs, stimulate demand for borrowing and thereby increase expenditure and demand in the economy. The MPC felt this was necessary in order to ward off their expectation that there would be a sharp slowdown in economic growth. Instead, the economy grew robustly, although the Governor of the Bank of England strongly maintained that this was *because* the MPC took that action. However, other commentators regard this emergency action by the MPC as being proven by events to be a mistake. Then in 2017, we had the **Financial Policy Committee (FPC)** of the Bank of England taking action in June and September over its concerns that cheap borrowing rates, and easy availability of consumer credit, had resulted in too rapid a rate of growth in consumer borrowing and in the size of total borrowing, especially of unsecured borrowing. It, therefore, took punitive action to clamp down on the ability of the main banks to extend such credit! Indeed, a PWC report in October 2017 warned that credit card, car and personal loans and student debt will hit the equivalent of an average of £12,500 per household by 2020. However, averages belie wide variations in levels of debt with much higher exposure being biased towards younger people, especially the 25 -34 year old band, reflecting their lower levels of real income and asset ownership.

One key area of risk is that consumers may have become used to cheap rates since 2008 for borrowing, especially for mortgages. It is a major concern that **some consumers may have over extended their borrowing** and have become complacent about interest rates going up after Bank Rate had been unchanged at 0.50% since March 2009 until falling further to 0.25% in August 2016. This is why forward guidance from the Bank of England continues to emphasise slow and gradual increases in Bank Rate in the coming years. However, consumer borrowing is a particularly vulnerable area in terms of the Monetary Policy Committee getting the pace and strength of Bank Rate increases right - without causing a sudden shock to consumer demand, confidence and thereby to the pace of economic growth.

Moreover, while there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two to three years will actually pan out.

**EZ.** Economic growth in the eurozone (EZ), (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and has now gathered substantial strength and momentum thanks to this stimulus. GDP growth was 0.6% in quarter 1 (2.0% y/y), 0.7% in quarter 2 (2.3% y/y) and +0.6% in quarter 3 (2.5% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in October inflation was 1.4%. It is therefore unlikely to start on an upswing in rates until possibly 2019. It has, however, announced that it will slow down its monthly QE purchases of debt from €60bn to €30bn from January 2018 and continue to at least September 2018.

**USA.** Growth in the American economy was notably erratic and volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1% and quarter 3 coming in at 3.0%. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.1%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with four increases in all and three increases since December 2016; and there could be one more rate rise in 2017, which would then lift the central rate to 1.25 – 1.50%. There could then be another four increases in 2018. At its September meeting, the Fed said it would start in October to gradually unwind its \$4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

**CHINA.** Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

**JAPAN.** Has been struggling to stimulate consistent significant growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

**Commentary provided by Link Asset Services ends.**

**Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management**

**SPECIFIED INVESTMENTS:** All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum ‘high’ quality criteria where applicable.

	<b>Minimum ‘High’ Credit Criteria</b>	<b>Use</b>
Debt Management Agency Deposit Facility	N/A	In-house
UK Local Authority Deposits	N/A	In-house
Term Deposits – banks and building societies	Minimum colour of green on our external treasury advisers credit rating matrix	In-house
Treasury Bills	UK sovereign rating	In-house
Certificates of Deposit or Corporate Bonds issued by banks and building societies	Minimum colour of green on our external treasury advisers credit rating matrix	In-house
Bonds issued by multilateral development banks	AAA	In-house buy and hold
Money Market Funds – CCLA (Church, Charities & Local Authority)	AAA	In-house (£10m limit for cash flow purposes)
Money Market Funds CNAV (Constant Net Asset Value)	AAA	In-house
Money Market Funds LVAV (Low Volatility Asset Value)	AAA	In-house
Money Market Funds VNAV (Variable Net Asset Value)	AAA	In-house

**Term deposits with nationalised banks and banks and building societies.**

	<b>Minimum Credit Criteria</b>	<b>Use</b>	<b>Max of total investments</b>	<b>Max. maturity period</b>
UK part nationalised banks	Minimum colour of green on our external treasury advisers credit rating matrix	In-house	£5m	1 year
Banks part nationalised by AAA or AA- sovereign rating countries – non UK	Minimum colour of green on our external treasury advisers credit rating matrix	In-house	£5m	1 year

If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.

<b>Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -</b>				
	<b>Minimum Credit Criteria</b>	<b>Use</b>	<b>Max % of non-specified investments</b>	<b>Max. maturity period</b>
Ultra-Short Dated Bond Funds with a credit score of 1.25	Long-term AAA volatility rating MR1+	In-house	100%	1 years
Ultra-Short Dated Bond Funds with a credit score of 1.5	Long-term AAA volatility rating MR1+	In-house	100%	1 years

N.B. buy and hold may also include sale at a financial year end and repurchase the following day in order to accommodate the requirements of the Accounting Code of Practice.

**Accounting treatment of investments.** The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

**NON-SPECIFIED INVESTMENTS:** These are any investments which do not meet the Specified Investment criteria. A maximum of £5m will be held in aggregate in non-specified investments.

#### **Maturities of ANY period**

	<b>Minimum Credit Criteria</b>	<b>Use</b>	<b>Max % of non-specified investments</b>	<b>Max. maturity period</b>
Fixed Term Deposits with variable rate and variable maturities: -Structured deposits	Sovereign rating of AAA or AA- and minimum colour of green on our external treasury advisers credit rating matrix	In-house	100%	5 year
UK Government Gilts	UK sovereign rating	In-house buy and hold	100%	5 year
Sovereign Bond issues (other than the UK govt.)	AAA	In-house buy and hold	100%	5 year
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government (e.g. National Rail)	UK sovereign rating	In-house buy and hold	100%	5 year

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Collateralised Deposits (see note 1)	UK Sovereign rating	In-house	100%	5 year
Bond Funds	Long-term AAA volatility rating MR1+	In-house	100%	5 year
Gilt Funds	Long-term AAA volatility rating MR1+	In-house	100%	5 year

*Note 1. as collateralised deposits are backed by collateral of AAA rated local authority Lender Option Borrower Option (LOBO)'s, this investment instrument is regarded as being a AAA rated investment as it is equivalent to lending to a local authority.*

### Maturities in excess of 1 year

	Minimum Credit Criteria	Use	Max % of non-specified investments	Max. maturity period
UK local authority deposits	N/A	In-house	100%	5 year
Term Deposits – banks and building societies	Sovereign rating of AAA or AA- and minimum colour of orange on our external treasury advisers credit rating matrix	In-house	100%	5 year
Certificates of Deposit issued by banks and building societies	Sovereign rating of AAA or AA- and minimum colour of orange on our external treasury advisers credit rating matrix	In-house	100%	5 year
Corporate bonds issued by banks and building societies	Sovereign rating of AAA or AA- and minimum colour of orange on our external treasury advisers credit rating matrix	In-house	100%	5 year
Bonds issued by multilateral development banks	AAA	In-house	100%	5 year
<b>Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)</b>				
Property Fund		In-House	£5m	Separate approval required
Corporate Bond Fund		In-House	£5m	Separate approval required

## APPENDIX G2b

The use of property funds can be deemed capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using. Appropriate due diligence will also be undertaken before investment of this type is undertaken.

Non treasury loans and investments with Welland Homes and South Holland Local Housing Company will not count towards the Non-Specified Investment limit.

The maximum total investment to any individual financial institution or its parent group is £5m and the limit with Money Market Funds is £10m.

Whilst these are maximum limits, under normal circumstances the Section 151 Officer will ensure lower limits are maintained. The higher limits are required to allow flexibility in the movement of funds if a particular issue or circumstance arises e.g. global banking crisis.

**Approved countries for investments**

This list is based on those countries which have sovereign ratings of AA- or higher (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong, Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link Asset Services credit worthiness service.

**AAA**

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

**AA+**

- Finland
- Hong Kong
- U.S.A.

**AA**

- Abu Dhabi (UAE)
- France
- U.K.